ajg.com.au

Emerging trends and growth hacking

What's shaping the insurance sector and Australian economy in the year ahead.

Market Overview Report

AJG1310_06/10/2016

Connect and join the AJG conversation

@AJG_Australia | in

Arthur J. Gallagher

What's inside

Welcome to our 2016 Market Overview Report that provides observations and the perspectives of our brokers on trends and critical changes playing out in the insurance sector. Whilst a number of these changes will come as no surprise to many of our clients, at the same time we are seeing a number of newly emerging patterns that are worthy of further consideration.

The market has presented both challenges and opportunities in 2016. Both direct insurance carriers and insurance brokers alike are navigating a new wave of complexity as we seek to provide effective risk management solutions for our clients. In an environment where price continues to be the first and often only consideration for many organisations, the industry is challenged with providing competitive solutions on one hand whilst remaining commercially stable on the other. Not easy.

In 2017, we expect to see new patterns of disruption affecting the insurance industry that will reconfigure the role of the traditional insurance broker. This is a good thing in many respects and further reinforces the relevance and value of having an expert on hand who is able to deliver practical as well as technical advice. We are well positioned to lead on this front and look forward to playing an active role in shaping the future of the industry.

Not generally viewed as a hotbed of creativity, the insurance sector is increasingly looking towards innovation as the way to capture new market share, as well as hearts and minds of the Australian business community. For insurance broking operations, this means taking a fresh approach beyond simply providing technical advice, towards a strategic advisory and consultancy based model.

Innovating traditional service models with digital points of service assisted by process automation is one area where investment is being directed. With the insurance sector ripe for innovation and receptive to disruption, we see this trend continuing in 2017 and investment levels are likely to increase.

Cyber risk remains topical in Australia's board room conversations following a number of high profile data breaches this year and a new wave of complex risks emerging from the shadows. With technology and the perpetrators of cyber crime becoming more sophisticated and agile, it is now feasible for an entire organisation to be disabled within a matter of hours, potentially minutes. We are also seeing claims becoming more complex with costs rising quickly from point of lodgement. This is one area where insurance will become more sophisticated in the next 12-18 months, focused as much on preventative measures as well as an appropriate remedy should a cyber attack take place.

We hope that you enjoy reading this report and would be delighted to discuss any aspect of the report and how it relates to your business.

Andrew Godden
Chief Executive, Australia
Arthur J. Gallagher

1 General Market Overview

2016 has been a year of continued change and disruption to clients across all economic and industry sectors. Insurance has not been immune to these changes and has been challenged with adapting and growing against a generally softer market.

Performance

The Australian insurance market remained highly competitive this year, with capacity exceeding demand in a majority of lines, Life Insurance and D&O being notable exceptions.

Unsurprisingly, the long-term trend of premium rate reductions has continued on from 2015 through 2016. Net earned premium for the financial year ending June 2016 was $30.6 billion, down by 3.4% from the previous year[1].

The Australian Prudential Regulation Authority (APRA) attributes the decrease to a rise in the overall level of reinsurance purchased in the market, but declining premiums have also played a role. Premiums have declined across product classes as clients have sought to reduce or control their costs, particularly around renewal periods.

Such cost-saving behaviour strongly correlates with macroeconomic conditions in Australia, such as slow growth, falling commodities prices and a weak dollar. Australian demand for commercial insurance is very much driven by the broader economy.

But despite falling premiums and intense competition, total industry net profit after tax for the previous financial year was $3.1 billion – up from $2.4 billion in the previous year[2]. Gross incurred claims for the same period totalled $31.1 billion, representing a 7% decrease from 2014/2015. The decline has much to do with an overall decrease in gross incurred claims for property classes, and a lower number of claims arising from catastrophic events relative to last year.

Looking forward to 2017, conditions in the Australian market are likely to remain similar to this year. Aggressive competition, increased merger and acquisition activity and more market entrances (particularly from global insurers) are to be expected. However, it is likely that we'll see premium rates harden and rates will likely decline at a slower rate.

Insights

The tide may be turning on premium rate reductions

While the trend of falling premium rates has been good news for clients, insurers are beginning to feel the impact on their margins and loss ratios.

Though the industry remains profitable overall, insurers have been operating at lower levels of profitability over the last 12 months compared with previous years. But premium outlook is improving: rates are continuing to decline, but the rate at which they are declining is slowing significantly.

Commercial insurance premiums have remained relatively stable (see Figure 1) and are forecast to grow by 1.1% in 2017[3]. This is attributable to a hardening of rates in key lines, such as professional indemnity. This, in conjunction with a relatively benign claims environment and a changing economic environment, should be good news for insurers in 2017 and 2018.

Source

1. Australian Prudential Regulation Authority (2016) Quarterly General Insurance Performance Statistics September 2016
2. ibid.
3. Swiss Re (2016) The Australian commercial insurance market

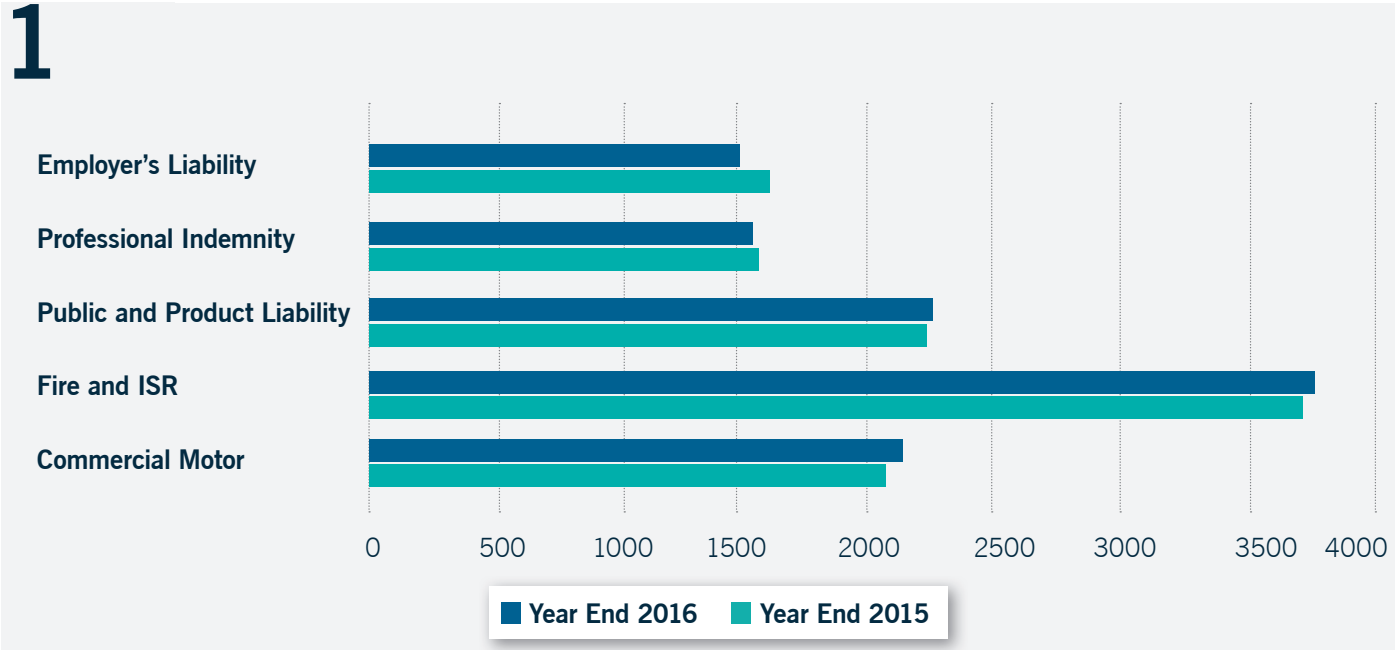


Figure 1: Gross written premiums in select commercial lines ($m). Source: APRA

But even as premium rates bottom out, insurers will continue to face a fiercely competitive and challenging environment. Innovating with new products that support the needs of Australia's emerging services sector will be key to finding sustainable success.

Australian businesses are underinsured

The Australian commercial insurance market is the 9th largest in the world, but despite falling premium rates (and, in particular, double-digit declines in commercial property and casualty premium rates) commercial insurance penetration is just 0.97% - compared to 1.6% in the US and 2.4% in the UK[1].

Commercial insurance penetration in Australia has remained steady over the past few years. Small to medium-size enterprises (SMEs) are the most underinsured of all firms: 1 in 8 SMEs don't have any insurance cover at all[2].

A survey conducted by the Insurance Council of Australia found that just 1.9% of insured firms had adequate cover in place, and around 10% of small businesses admit to being underinsured[3]. The top reasons cited for not purchasing insurance included lack of time, prohibitive cost and lack of perceived value and/or risk[4].

Addressing these root causes of underinsurance provides an opportunity for insurers to innovate and become more competitive in key commercial lines - particularly liability, which makes up 33.6% of total commercial insurance premiums in Australia. Brokers are also in a prime position to become trusted advisors for risk-aware but underinsured SMEs.

The changing composition of the Australian economy is impacting some commercial lines

Commercial property insurance penetration has continued to drop throughout 2015 and 2016, following an 8.6% decline in 2014[5].

Between 2004 and 2015, commercial property insurance decreased from 0.33% to 0.24%, coinciding with the decline in the manufacturing sector's share of Gross Domestic Product (GDP).

Indeed, only 37.7% of SMEs surveyed by the Insurance Council Australia nominated plant and machinery insurance as being 'worth it' or relevant to their business[6]. Furthermore, nearly 80% of SMEs surveyed by Vero this year cited machinery or equipment breakdown as a major area of concern for which they are not insured[7].

The share of total GDP continues to decline for the mining and manufacturing sectors as the Australian economy pivots towards the services sector, and this will have an impact on some commercial lines, including property.

Moreover, considering Australia's exposure to extreme weather and other catastrophe events, property risk – both commercial and residential – remains underinsured.

According to sigma, Australia faces an estimated total annual insured loss of USD 3.4 billion. The property gap remains even though premium rates are hardening in this area. Insurers and brokers will benefit from raising awareness of key commercial lines and targeting professional services.

Source
1. Swiss Re (2016) The Australian commercial insurance market
2. ibid.
3. Insurance Council of Australia (2015) 2015 Survey on non-insurance in the small to medium enterprise sector
4. ibid.
5. Swiss Re (2016) The Australian commercial insurance market
6. Insurance Council of Australia (2015) 2015 Survey on non-insurance in the small to medium enterprise sector
7. Vero (2016) SME insurance index report 2016

1 General Market Overview

continued...

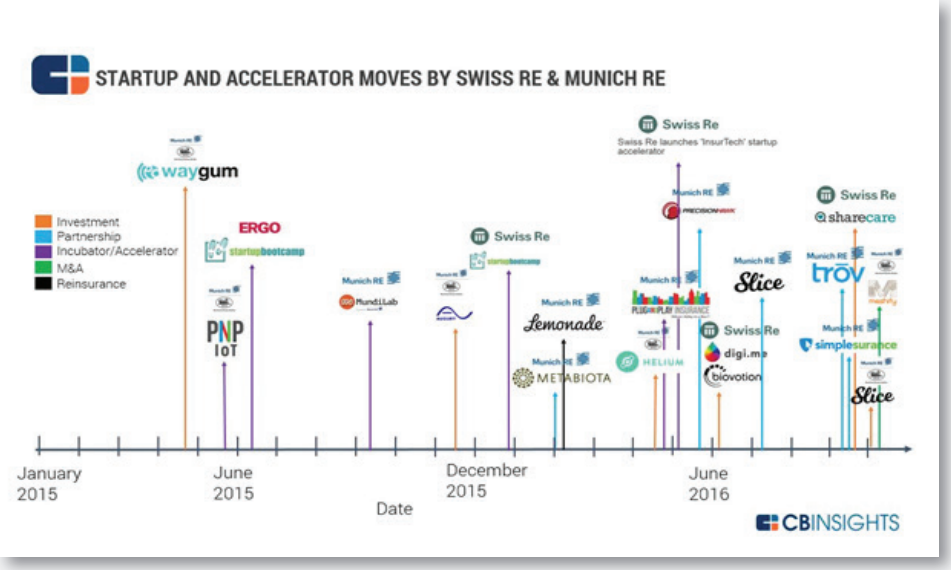


Figure 2: Startup and Accelerator moves by Swiss Re and Munich Re

Source: CB Insights

Insurance is ripe for disruption

A number of trends and technologies have emerged in recent years which are not threatening to disrupt the insurance industry. They already are.

Insurtech

Major insurers including AXA and Allianz, as well as reinsurers Swiss Re and Munich Re, have been busy investing in insurance-related tech start-ups across the globe. Swiss Re and Munich Re in particular have been actively establishing accelerator programmes, partnerships and other ventures (see Figure 2) as they continue their foray into the 'insurtech' industry[1].

In the United States, start-ups developing products aimed at small business insurance have collectively raised almost $80 million in funding since October 2015[2]. Relatively speaking, there has been far less activity in the Australian start-up scene, but there is demand from Australian insurers for new disruptive products and technologies that improve their customer experience and service delivery capabilities.

Suncorp Group's USD 5 million equity stake in US start-up, Trov[3], foreshadows a future of more engagement between insurers and tech companies in Australia. The emergence of forums and groups like InsurTech Sydney also suggests that the Australian insurance community is on the cusp of actively embracing insurtech over the next few years.

Driverless cars

This year saw Uber launch its driverless car service in a landmark trial in Pennsylvania, while tech giants Apple and Google advanced their driverless car development programmes. We also saw the emergence of vehicles with 'driver assist technology', most notably those created by Tesla.

The Insurance Council of Australia notes[4] that the trend towards driverless cars and automated vehicles has the potential to increase safety for road users, but highlights the need to review and update existing road safety regulatory frameworks. The potential varying degrees of automation carry an array of 'complex liability issues' with impacts that extend far beyond road users to manufacturers and insurers.

It's unlikely to become a pressing issue over the next 12 months, but as more automated and semi-automated vehicles hit the road insurers will have to address the growing issue of liability and attribution for loss and damage.

It's possible that as this industry evolves, motor insurance will become more closely aligned with liability classes. We may also see the creation of additional products in the motor insurance space to cover emerging risks, such as cyber security.

Source

1. CB Insights (2016) The Startup & Accelerator Moves of Reinsurance Giants Munich Re & Swiss Re
2. CB Insights (2016) Top Deals in Insurance Tech
3. Suncorp Group (2016) Swipe right to protect with Trov, the world's first on-demand insurance for single items press release May 2016
4. Insurance Council of Australia (2016) ICA submission to the National Transport Commission Issues Paper – Regulatory barriers to more automated road and rail vehicles

1 General Market Overview

continued...

Cyber risk

A number of insurers have launched cyber insurance products in the Australian market and revealed new capabilities within their coverage and breach support services.

This has come off the back of increased awareness of cyber risk fuelled by high-profile data breaches and cyber attacks against organisations including the Bureau of Meteorology and the Reserve Bank of Australia. The Lloyd's City Risk Index[1], released in November this year, warned that the Australian economy will be exposed to a potential $16 billion damage bill over the next decade, largely due to the rising frequency and complexity of cyber attacks.

Premiums are being directly impacted by risk management within organisations, and managing this will be the key to the sustainability and longevity of cyber insurance products.

*

$16bn

exposure to damage over the next decade from cyber attacks

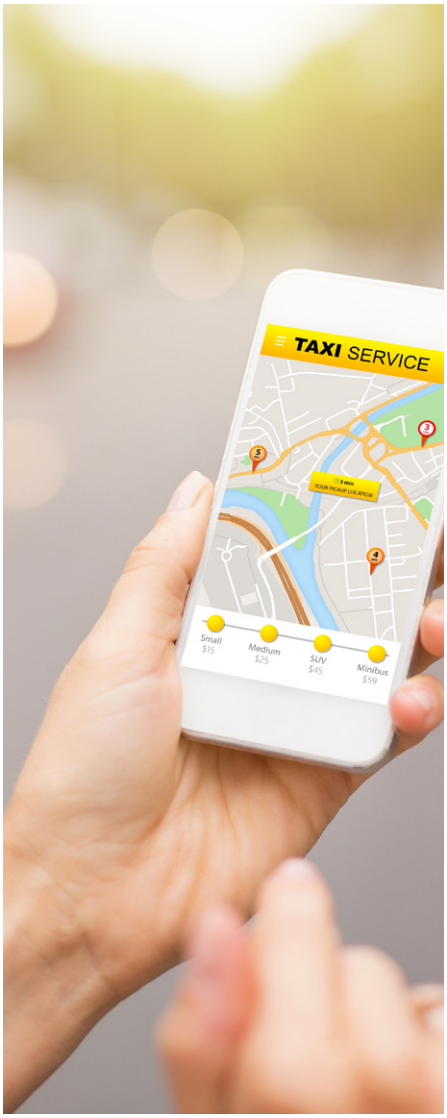
The sharing economy

The rise of 'collaborative consumerism' popularised by services like Airbnb, Uber and GoGet, are changing the way people buy and sell. Peer-to-peer services that enable individuals to exchange goods and services between each other is also having a significant impact.

In the insurance space there are a reported 15 peer-to-peer insurers operating globally. These insurances typically group customers by policy, and premiums are then combined to create a pool of funds from which claims are paid. This model has the potential to save consumers money, but Australia is yet to see a major peer-to-peer insurance success story.

The recent emergence of Lemonade in the US and Berlin-based Friendsurance, which launched in Australia in 2016, will test the potential and appetite for peer-to-peer insurance in the market.

Australians tend to be early adopters of new technologies[2], making the country an attractive market for disruptive services. Regardless of the success of Friendsurance, it's highly likely that we'll see more peer-to-peer insurers test the Australian market in coming years.



Source
1. Lloyd's (2016) Lloyd's City Risk Index 2015 – 2025
2. Department of Industry, Innovation and Science (2016) Adoption of digital technologies by Australians

2 General Liability

Overview

General liability is the largest commercial line in the Australian market, accounting for 33.6%[1] of all commercial lines. It remains a profitable area of business despite a decline in market penetration over the last 10 years. Currently, premiums account for just 0.33%[2] of GDP.

Average rates have fallen by about 4% for most industries with the exception of some (such as Energy and Transport & Logistics), which have seen much smaller reductions. Overall, rates have continued to reduce by up to 20% in 2015 and 2016, consistent with general market trends.

We are also seeing a downward push on deductible structures and the inclusion of automatic additional covers, such as small limits for environmental liability covers.

Source
1. APRA
2. APRA and Swiss Re.

Observations

We have seen both clients and insurers be more willing to enter into longer-term agreements for periods of 2-3 years, as they perceive we are currently at the bottom of the market cycle. For clients, this gives budget certainty for a longer period of time and also quarantines them from any premium movements and narrowing of coverage.

General liability policyholders are seeing real value in the adequacy and quality of their claims service team. In some cases this is translating into insurers providing a claims promise or contract to provide an increased level of surety and reassurance, especially with large frequency accounts where it makes sense to have a specialist claims team on call.

A number of Australian organisations have been able to take advantage of premium reductions to purchase larger limits of cover, which is also indirectly working towards plugging the underinsurance gap that has been emerging over the past 12-18 months.

From an underwriting perspective, insurers are looking for good quality underwriting information to assess their ability to offer their capacity. In general, higher quality information produces better coverage and premium outcomes at renewal.

A Perspective

"Insurers are seeking to adjust the rating on their renewal portfolios, particularly on accounts causing continuing losses. Generally speaking, accounts without claims will be rated on a stable basis, with business causing unsustainable loss ratios being corrected accordingly.

"Furthermore, there has been a withdrawal of capacity both here and in London on "slip, trip and fall" (frequency) business, such as public venues and shopping centres, particularly to the contractors engaged by these asset owners. This is also driven by the continual marketing of litigation lawyers, causing increased claims reserving thus putting pressure on underwriting profitability.

"Yet again certain insurers will be aggressive on new business, particularly the industry segments that will have a low to medium exposure to loss, or deemed a severity risk where insurers can price accordingly."

Ryan Gooley | Martin Andrews

3 Professional Indemnity

With ASIC reporting potential gaps in coverage for many Australian businesses, professional indemnity (PI) remains firmly in the spotlight. A growing number of reported cyber breaches is raising concerns about the ability of standard PI cover to mitigate evolving risk exposures and complexity.

Overview

Professional indemnity continues to be one of the main product lines in the general liability market. Last year, the national average for written premiums fell by 9.5%, with APRA-regulated general insurers writing $1.34 billion of gross premium in the 2015 underwriting year[1]. That's a 3.8% drop from the previous year.

Premiums fell across all states and territories except for the Northern Territory, continuing a long-term trend of declining average premiums. In the past five years alone, average written premiums have fallen by almost 30%. Despite this, PI lines continue to be profitable and combined ratios have remained stable, if not improved.

Observations

In the first half of 2016 we saw renewal premiums fluctuate modestly, reflective of global trends. Excess capacity and aggressive competition have allowed for discounts to become available to clients with good risk management and minimal loss histories, which is good news for price-sensitive customers.

But clients with high risk exposures are having a difficult time finding the right cover. Indeed, some industries are seeing PI rates harden, largely due to macroeconomic trends; below-target inflation, forecasted growth and a rising services sector are driving the demand for PI insurance.

The hardening of rates along with increased stability in property lines pricing will likely contribute to modest growth in commercial insurance premiums going into 2017.

A Perspective

"We can probably expect to see claims increase in frequency and cost over the next few years, stabilising combined ratios. This is largely due to the rising number of exposures that professionals and businesses in the services sector are facing, such as data security and cyber risk, exposure to reputational risk through social media, as well as increased regulatory activity.

"As the professional services sector expands, so will its exposures and risk factors, and this will contribute to further demand for professional indemnity policies."

Stuart Davies
National Practice Leader - Professional & Financial Risks

Source
1. APRA

4 Cyber

Cyber is now recognised as being the number one economic crime in Australia. The Government has responded with a $230m Cyber Security Strategy and the creation of more than 100 new jobs to boost Australia's cyber security capacity and capabilities. As such, cyber is now recognised as a universal threat to organisations of all sizes from small home businesses through to multinational corporates.

Overview

Australian boards are slowly awakening to the clear and present danger of cyber attacks following a spate of high-profile cyber security breaches at global level over the past 24 months.

With cyber criminals becoming increasingly sophisticated and the threat level evolving at an expeditious rate, no company is immune. Apple, Sony, JP Morgan Chase, British Airways and the European Central Bank are among high-end corporates to fall victim to hackers or malware, while the infamous Ashley Madison 'hacktivist' attack of 2014 brought the issue to the forefront of consumer consciousness like never before.

While Australian corporate entities have so far avoided the high-profile losses chronicled above, uptake of cyber insurance policies is on the rise – notably in financial and professional services, and in the healthcare, energy and government sectors. But the level of take-up does not accurately reflect the level of risk.

With abundant competition and appetite within both the local insurance market and Lloyds-based syndicates out of London, there is significant capacity in the cyber insurance sector and relatively static pricing is reflective of that.

However, with many cyber security incidents across the private sector going either undetected or unreported, accurate pricing of cyber risk remains a challenge for underwriters.

Observations

The increasing levels of class actions taken against Australian directors and officers should sound alarm bells in board rooms across the country and elevate cyber security issues to the top of agendas.

The threat is three-fold as cyber security breaches have the impact to cause considerable damage both to a company's reputation and its share price – beyond that of the cost of the breach itself, which can be considerable.

According to the latest research from IBM and the Ponemon Institute, the average total cost of a data breach to an Australian company is $2.64 million – with the average cost of each lost or stolen record sitting at $142[1].

This, however, doesn't tell the whole story. The study excludes organisations with data breaches in excess of 100,000 records because they are atypical. The message remains clear, though: the more records a company holds, the higher the potential cost in the event of a breach.

The number of cyber incursions suffered by Australian businesses continues to skyrocket. Between July 2015 and June 2016, CERT Australia responded to 14,804 cyber security incidents affecting Australian businesses, 418 of which involved systems of national interest and critical infrastructure[2].

Source

1. Ponemon Institute. 2016 Cost of Data Breach Study: Australia
2. Australian Cyber Security Centre 2016 Threat Report

4 Cyber

Robyn Adcock

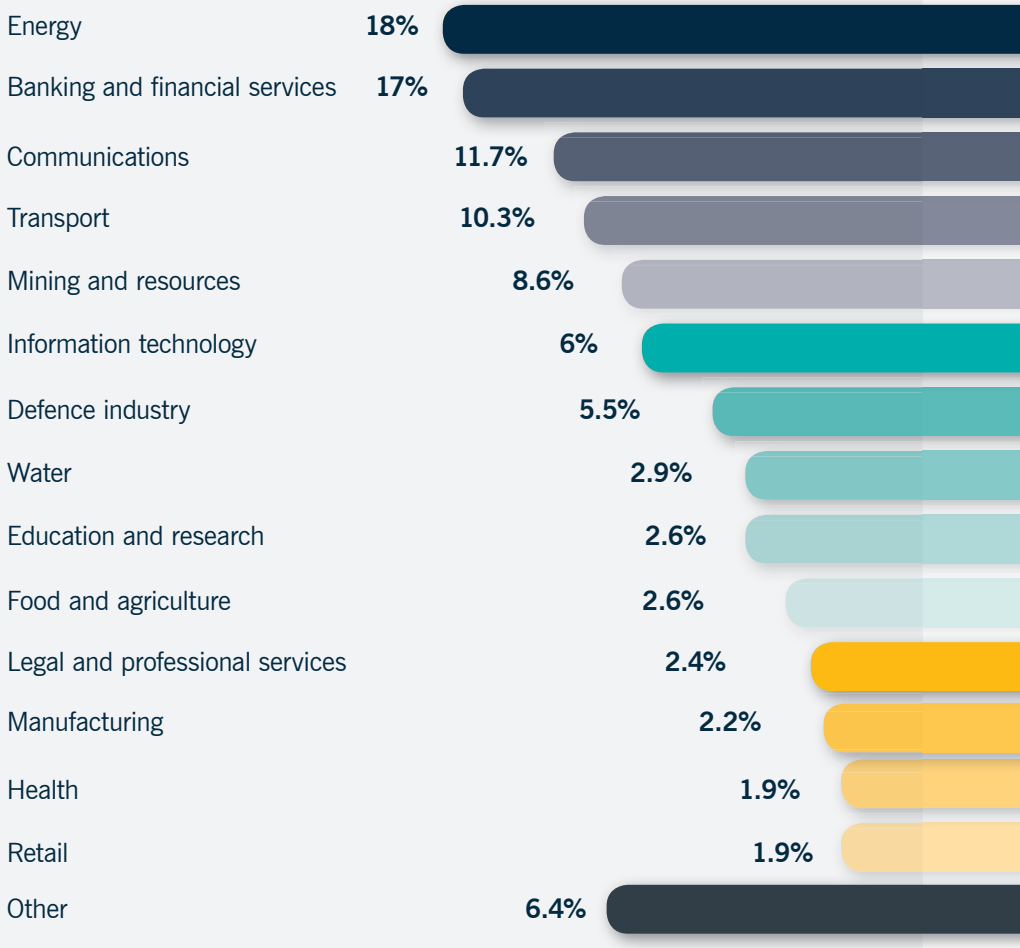


Figure 3: Cyber security incidences by sector - Australia

Source: Australian Cyber Security Centre 2016 Threat Report

That figure is expected to continue to rise, and the Federal Government has made moves to build resilience and understanding of the cyber threat to the corporate sector. The Government's $230m Cyber Security Strategy, announced in May 2016, offered top 100 ASX-listed voluntary 'cyber health checks'.

The expected imminent passing of mandatory data breach notification legislation promises to be a landmark occasion, both in terms of directors' and officers' accountability surrounding cyber security issues, but also in helping underwriters collate more meaningful data in order to accurately price this risk in future years.

A Perspective

"Mandatory data breach notification legislation is a matter of when and not if, so now is the time for Australian company boards to ensure they are proactively preparing for the new era.

"Internal breach response and crisis management plans should be set in place, and contracts with external providers who handle personal information should also be updated to include data breach notification obligations.

"Inactivity is not an option. Boards who demonstrate poor discipline around cyber security threats will face a high risk of class actions in the event of a data breach, intrinsically linking cyber security to D&O insurance programs.

"Cyber insurance should be robustly discussed at board level, but it's important to remember that it should be adopted as part of a comprehensive cyber risk mitigation strategy, not simply applied as a back-up option."

Robyn Adcock
Professional & Financial Risks

*

$2.46m

Average cost of a data breach to an Australian company in 2016

5 Property

Ryan Gooley | Martin Andrews

Overview

A competitive landscape, high capacity and an eroding premium pool are making the property segment a tough but stable line of business for insurers.

Investment income has been unable to boost underwriting losses for many insurers this year, reducing bottom line profit figures. As a result, we're beginning to see a firming of premium rates across property lines and renewal portfolios, potentially ending the long-term trend of 10-20% year-on-year premium reductions.

This is particuarly true for accounts with loss histories, and accounts with high exposure to catastrophes and natural disasters. Given the impact of rate reductions and capacity on loss ratios, it's not surprising to see ratings on renewal portfolios firming.

Observations

Merger and acquisition activity, along with new market entrances, such as Berkshire Hathaway, has increased competition and capacity in the property market. However, insurers are being more conservative and selective in their approach to renewal business and in providing cover in certain sectors where their exposures may be high.

Property, for now, is a two-speed insurance market. However, some insurers are still keen for new business and are aggressively pursuing it in certain industry segments.

A Perspective

"Activity around the major trading period in June 2017 will be a good indicator of where renewal rates are heading in this segment. Competition for select new business opportunities will continue, but rates are likely to firm.

"Moving forward, certain sectors of the property market will remain a challenge for insurers. The retail property sector is still seeing an ongoing trend of claims deterioration, prompting scrutiny from insurers and underwriters. Premiums have risen in some cases, but this hasn't been driven by rising claims frequency. Rather, the costs of managing and defending claims has driven premiums up.

"Prolonged economic downturn and high exposure to third-party risks will force insurers to be more selective in providing cover in some sectors, such as mining and resources."

Ryan Gooley | Martin Andrews
Property

6 Directors' and Officers' Liability (D&O)

Overview

Abundant capacity and increased competition from local and international underwriters have contributed to reductions in premiums in the D&O segment of the market over a number of years. However, further premium rate reductions are now looking less likely.

While soft market conditions have been advantageous for the insureds, the profitability outlook for D&O insurers is poor. Australia's annual D&O premium pool currently exceeds $200m, but loss ratios are estimated to have been close to 100% since the GFC in 2008.[1]

Some consolidation in the Australian insurance market through the mergers of ACE with Chubb and XL with Catlin, together with the exit of AXIS, is now starting to bite and capacity reductions or coverage limitations for certain risks have been readily followed by other market participants.

Observations

An ongoing challenge for D&O insurers is the ability to price adequately for current and future shareholder class actions, which are a key driver of long-tail claims and which are rapidly on the rise in Australia – increasing by more than 100%, between 2014 and 2016.[2]

Economic volatility has traditionally been a forerunner to class action claims, and with stock market instability expected as the impact of Brexit and the election of Donald Trump as US President unfold at global level in 2017, the longer-term outlook for the D&O market remains uncertain at best.

Closer to home, with the Australian Securities and Investments Commission (ASIC) granted more powers earlier this year to combat misconduct in Australia's corporate sector, boards can expect to be under heightened scrutiny from a watchdog keen to prove its relevance to a sceptical public.

The rising cyber threat

The D&O sector also has the potential to be disrupted by cyber threats, with uncertainty existing over the level of accountability directors and officers will face when it comes to cyber security breaches.

In May 2016 the Australian Government announced that voluntary 'cyber health checks' would be offered to Australia's ASX top 100 companies as part of its $230m Cyber Security Strategy to build resilience and education at the top of the corporate ladder.

In September 2016 ASIC Commissioner Cathie Armour reportedly urged: "Directors should improve their knowledge about cyber security, assess technology vulnerabilities more regularly than other business risks, and develop more comprehensive plans for responding to attacks."[3]

With the Government still indicating its intent to forge ahead with new legislation to create a mandatory breach reporting scheme, this is an issue that will only become a hotter topic of conversation in Australian board rooms in 2017. The valuable role insurance brokers can play in advising on the insurable risks surrounding cyber security issues cannot be underplayed.

continued overleaf >>

6 Directors' and Officers' Liability (D&O)

continued...

Michael Herron

A Perspective

"In recent years, D&O insurance has been a relatively simple proposition. Abundant capacity attracted by historical profitability has created strong competitive tension in the market, which has had a positive response from insureds seeking both increased coverage and reduced premiums.

"Interestingly this has occurred against a backdrop of high profile corporate failings and an increasingly hostile intention to hold directors and officers personally liable for their involvement in any corporate, financial, environmental or workplace health & safety issues.

"However, we're seeing signs that the financial performance of Australian D&O insurers is attracting more attention. We're also seeing the first signs of underwriters' appetite diminishing. High-exposure industries, including resources and construction, will continue to require particular care and skill in the negotiation and placement of any D&O insurance program."

Key takeaway for Directors:
"How well you present your risk profile to insurers will impact D&O program negotiations. Any contingency with potential shock value requires sound explanation. We anticipate that the expertise and experience of brokers will be tested in this regard in coming renewals."

Michael Herron
Practice Leader,
Financial & Professional Risks

Source
1. Finity, Pendulum 2016
2. King & Wood Mallesons Class Actions in Australia 2015/2016
3. 'Cyber security more than just for IT guy' James Eyers, The Australian Financial Review, 14 September 2016
Addional information: APRA: Quarterly General Insurance Performance Statistics, September 2016 (released 17 November 2016).

7 Financial Institutions

Stuart Davies

Overview

Another area of the market with capacity and appetite in abundance, the financial institutions insurance sector has remained relatively static in terms of renewal premium pricing over the past 12 months. However, we have witnessed some market movement in terms of carrier appetite.

Aggregation exposure has become a key focus for insurers, especially where capacity is deployed across a number of key risk classes such as professional indemnity, D&O liability and crime. M&A activity within the market (such as the ACE/Chubb merger) also has the potential to impact capacity in 2017.

The removal of AXIS Specialty from the Australian market has certainly impacted the mid-tier FI sector, with a ripple effect affecting financial planning and stockbroking in particular. Although alternate capacity has presented itself to the market with the entrance of new carriers such as Berkshire Hathaway, maintaining the level of premium and coverage can be challenging if not negotiated effectively.

In addition, as typically occurs, the London market cycle tends to operate counter-cyclical to the local market, resulting in an increasingly aggressive approach being experienced from overseas. Access to cost effective capital from the London market is expected to be a trend that continues into 2017.

Overall, we expect the competitive market conditions to continue to maintain pressure on premiums in 2017, offering broad coverage options at cost-effective levels.

A Perspective

Stock market volatility

"This class of insurance is sensitive to stock market volatility. As a result, the outcomes of Brexit and the market response to Donald Trump's election will be closely scrutinised by insurers both locally and internationally. With the Lloyd's of London market aggressively competing for Australian business, corporate entities looking to spread their risk may be in a strong negotiating position. Pricing is a key factor in influencing purchasing habits, so insurers who are able to show they are innovating and keeping pace with technological changes in a sector ripe for disruption are in prime position to stand out.

Emerging risks

"With financial institutions themselves operating in a rapidly-evolving and increasingly disrupted environment, cyber breaches and network security are burning issues that should be at the forefront of board room discussions.

Alongside traditional D&O and PI insurance, cyber insurance cover can no longer be ignored - but the complex and often confusing terminology surrounding cyber security means it is not always fully understood. A thorough risk analysis with an experienced broker should be a pre-requisite in order to identify any gaps in coverage, and also to ensure existing cover that may have limited cyber liability coverage is up to standard.

"Traditionally, financial institution programs have offered broad coverage for risk issues such as identity fraud and electronic crime. But the ever-increasing risk of a data breach requires a closer validation of existing programs. Another key point for consideration is the inherent impact upon financial institutions of reputational damage.

"Reputation risk requires particular consideration in our media-driven society, where it's increasingly common to see the actions of companies and individuals sensationalised and often misconstrued. As a result, seeking an insurance and risk solution that effectively addresses reputational risk issues is highly recommended for financial institutions."

Stuart Davies
National Practice Leader - Professional & Financial Risks

8 Workplace Risk

Overview

As the economy transitions from the mining and resources boom, the Australian workplace is adapting in response to new growth sectors and changing workforce requirements. Technology is advancing at an exponential pace, fuelling a desire for flexible and agile working patterns and an increased focus on streamlining traditionally labour intensive or repetitive manual tasks.

In 2017, ongoing developments in the digital health space will begin to transform the role of employers in managing the wellbeing and safety aspects workforce, with benefits including the ability to monitor ongoing healthcare requirements with lower human intervention and a reduced time for injured workers to return to work.

A push for better management and understanding of workplace stress, alongside improved health & safety provisions, will require employers and business owners to take a more holistic approach to workplace risk. With stress related illness costing Australian businesses somewhere in the region of $20 billion per year, we are likely to see increased calls for an effective action plan with more focus on taking preventative measures than reacting with remedial, post-event follow-up.

In Victoria, reported workplace injuries fell to a record low reflecting continued improvements in safety prevention and awareness, with a new low of 6.95 claims per million hours being reported by WorkSafe.

Ongoing reforms to Australia's workers' compensation system will continue into 2017. Reducing workers compensation claims and recovering lost productivity will remain a challenge for many organisations throughout 2017 and beyond, as will the impact of compensation gaps for those employees with more complex and/or longer term support needs.

Fair work practices have remained in the spotlight this year, with the number of employment practices liability claims on the rise placing increased emphasis of employers to provide a safe and fair working environment, free from discrimination, bullying and harassment. The onus remains on business owners to review their leadership culture and also the structure and scope of their insurance cover to ensure they have the right policies and governance frameworks in place, along with adequate protection should a claim arise.

A Perspective

"Ongoing reforms to workers compensation schemes are likely to deliver a range of benefits back to the employers and employees alike. Increased focus on driving simplicity, such as the recent decision in NSW to move policy management and billing to icare in early 2017 using online, self-service portal and a customer service centre, are signalling further changes to come."

"This will open up new opportunities for insurance brokers to play a more proactive role in supporting Australia's employers to deliver a more effective solution to their clients. At the same time, we still have ongoing concerns about the management of more complex claims in some states, where regulatory changes have created gaps in definition and delivery."

Geoff Sawers
Practice Leader
NSW Workers' Compensation

8

Workplace Risk

continued...

Workers Compensation

Comcare legislation has stalled in the Senate, despite the best attempts of Senator Abetz to promote important changes designed to deliver improvements to the scheme in late 2015. At time of writing we are monitoring this situation with interest to see how this unfolds in the coming months.

The Aucote decision at the end of 2014 ruled that the *Seafarers Act* applies to all employees of a trading, financial or foreign corporation. This amendment of the Act, together with exemptions issued by Seacare, bring coverage back to the pre-decision understanding.

New South Wales

In early November, the NSW State Regulatory Authority launched their first report on the performance of the workers compensation system. The report identified a number of key improvement areas and areas where further review is required for the period 2014/15. Moving forward, the State Insurance Regulatory Authority (SIRA) is planning to release an annual report to provide a comprehensive update on how the system is performing and where further regulatory intervention is required to deliver additional improvements over time.

On 1 August, 2016, SIRA implemented a refreshed set of Guidelines which supersede four guideline documents.

The Workers Compensation Amendment (Return to Work Assistance) Regulation 2016 commenced on 29 April 2016. The major changes include clarifying that an injured worker's employer is not liable for the costs of helping them return to work with a new employer if the new job offer is for three months or less, or has not been made in writing. The employer is also not liable for the costs of retraining the worker if the training is inconsistent with the worker's injury management plan or not approved by an approved training / education organisation.

In NSW, new workers compensation regulation (replacing the 2010 Regulation), introduced a number of important changes including updating prescribed medical tests, the removal of unnecessary clauses and alignment to workers compensation legislation.

icare has transitioned employers to a new premium scheme with a transitional 30% cap on increases to the premium percentage rate for the 2015/16 and 2016/17 policy periods. The coming year will see icare manage premium collection and policy management for all NSW Employers whilst promoting the use of Risk Advisers / Consultants as playing a key role in helping experienced rated businesses.

Western Australia

There has been a steady decline in compensation claims lodgement, with 17% fewer claims being submitted in the period 2015/16 as compared to the period 2012/13. At the same time, the proportion of long duration claims (60+ days) has increased from 26% to 34%, whereas the volume of short duration claims (1-59 days) has declined from 74% to 66%.

Return to Work statistics, as well as injury management provisions, indicate there is still further work to do to get more people back into the workplace and contributing to business growth.

South Australia

Following changes to the workers compensation scheme in July, almost 3,000 workers lost access to their benefits, placing a new challenge on Return to Work schemes in the state. Out-of-pocket medical expenses are also likely to rise as a result of these changes with many people looking to Medicare to bridge the gap, accepting that the level of care provisions may be less than workers' compensation provisions historically.

8 Workplace Risk

continued...

Victoria

We have seen a number of noteworthy changes playing out this year, including the exit of QBE as a Scheme Agent following the Licencing Renewal and a new Licence granted to Employers Mutual Limited (EML). A market freeze was applied while clients moved from QBE to either Xchanging and EML, which will lift on 1 January 2017.

This year also saw changes to administrative arrangements for employer excess on claims, where the employer pays the agent direct and then the agent pays the provider.

Queensland

The Workers' Compensation and Rehabilitation (National Injury Insurance Scheme) Amendment Bill 2016, tabled in June, included a provision for lifetime care for catastrophic injuries as a statutory benefit under the Act. It also includes the ability to opt out in preference of an allowance for lifetime care which can be included in a Common Law settlement.

Other amendments to the Bill included Self Insurance licensing, which enables general insurers to issue a security as an alternative to a bank guarantee. The Bill was also amended to include a provision that the insurer is not liable for the indemnities provided by an employer to a third party.

Tasmania

This year saw a number of changes introduced in Tasmania, including a red tape reduction program to open up consultation with the industry, improve efficiency and also remove barriers for the scheme. We are likely to see rate increases in 2017 which we will report on in the coming months as trends become clearer.

Following scheme changes introduced in the 2010 Clayton Review there have been subsequent changes to common law threshold and benefits. As a result, we expect to see:

- improved access to common law via reduction of the Whole Person Impairment (WPI) threshold to 20%;
- an estimated 15% increase to average claim size; and
- actual charged rates in the scheme are predicted to be 13% below the recommended rate for the scheme.

ACT

Average premium rates in 2017 are expected to increase to 2.70%, up from 2.65% in 2016, largely due to higher allowances made for lump sum claims.

We are also likely to see rate increases driven by Lifetime Care requirements referenced in the *Workers' Compensation and Rehabilitation Act 2003*.

Ageing population

Australia's changing demographic will transform the insurance risk profile over the next 10-15 years. The number of people aged 65 and over has more than tripled over the past 50 years, to more than 3.4 million in 2014. From a workplace design and risk perspective, an increase in flexible working arrangements plus the need to adapt individual working spaces to accommodate different requirements will place a new type of cost pressure on Australia's employers.

The Australian Government has recognised the critical importance of factoring in a mature age working population and what this segment of the workforce in terms of skills and opportunities to drive sustainable growth.

The need to have effective strategies in place to manage a rapidly ageing workforce, including wellbeing programs, skills base training and stepping up efforts to eliminate easy to resolve risks are high on the board room.

Source
1 WorkCover WA, Workers' Compensation Scheme Trends, October 2016
2 Australian Bureau of Statistics report, 2015

8 Workplace Risk

continued...

21st century workplace

Fair Work legislation is giving employees greater flexibility to explore alternative working arrangements in the desire for increased work/life balance and improved productivity and effectiveness. Like all changes, there are upsides and downsides that are challenging organisations of all shapes and sizes to think differently.

With an increasing demand to provide 'work from home' options, employers are required to adjust and adapt their workers compensation platform, to provide appropriate safeguards to incorporate specific risks that would not generally form part of a traditional workplace risk profile. This often requires specialist knowledge and expertise that may be outside of the reach of many businesses.

A Perspective

"Workplace risk complexity is increasing as we move towards the agile and mobile office of the future. Technology, innovation and changing lifestyle expectations brings a new dimension to the conversation. Australian employees need to be well placed to respond to these changes and advice clients on their next best decision."

"One area of concern is the inadequate level of cover and risk management infrastructure inside organisations of all shapes and sizes. This is not a new phenomenon, but it does point to the need for wholesale changes across many businesses.

"With more than $60 billion lost through injuries and workplace related incidents in 2015, even small incremental improvements in workplace health & safety provisions will redeem benefits in terms of increased funds for growth, innovation and research & development investment."

"We are seeing more organisations focus on creating a more effective leadership culture to raise visibility of workplace risk and workplace health & safety and reduce the incidence of injuries and to reduce stress levels."

"Also high on the agenda are Return to Work policies and schemes, designed to get people back into the workforce, reduce the burden on compensation arrangements and address declines in productivity. There's no doubt the 21st century workplace is becoming more complex – not only in terms of risk assessment and evaluation, but also in terms of managing a much broader spectrum of risk that translates from the board room down into the office or shop floor."

Vivienne Toll
Head of Workplace Risk

Contributors

Andrew Godden
Chief Executive, Australia
T: +61 2 9242 2001
M:+61 413 443 072
in | Connect with me

Mark Oatway
Head of Corporate Broking
T: +61 2 9242 2062
M: +61 408 346 173
in | Connect with me

Stuart Davies
Financial Institutions
T: +61 2 9242 2065
M: +61 412 780 075
in | Connect with me

Michael Herron
Directors & Officers
T: 61 2 9242 2064
M: +61 466 391 061
in | Connect with me

Robyn Adcock
Cyber
D: +61 2 9242 2008
M: +61 414 971 918
in |Connect with me

Ryan Gooley
General Liability and Property
T: +61 2 9242 2036
M: +61 407 887 470
in | Connect with me

Martin Andrews
Property
T: +61 2 9242 2053
M: +61 412 702 551
in | Connect with me

Vivienne Toll
Workplace Risk
Workers Compensation
T: +61 2 9242 2084
M: +61 466 429 224
in | Connect with me

Geoff Sawers
Workers' Compensation
T: +61 2 9242 2109
M: +61 429 722 393
in | Connect with me

Damien Stinson
Practice Leader - Workplace Risks
T: +61 2 9242 2027
M: +61 423 349 729
in | Connect with me

Beverley Price
Complex Risks
T: +61 2 9424 1840
M: +61 411 744 656
in | Connect with me

Paul O'Brien
Corporate Risks
T: +61 3 9412 1144
in | Connect with me

Why Gallagher?
Arthur J. Gallagher's Corporate Broking team is working in partnership with a diverse portfolio of corporate businesses, from home-grown Australian brands through to large multinational organisations. Together with clients, we shape strategic insurance and risk management solutions for your business that help them take their plans forward.

If you are looking to work with a team who can help you to protect your business against all insurable risks whilst supporting your ambitions to grow, look no further. For an informal discussion on how we can help your business, please get in touch with any member of our team profiled above. Alternatively visit our website at **ajg.com.au**

ajg.com.au

About Arthur J. Gallagher

Arthur J. Gallagher is one of the world's leading insurance brokers and risk solutions providers. Globally, with more than 20,000 employees, located in 400 offices in 31 countries, we provide a comprehensive range of insurance and risk management solutions, competitively priced through access to our global insurance partner relationships.

Globally, Arthur J. Gallagher & Co. (NYSE:AJG) has operations in 30 countries and offers client-service capabilities in over 140 countries around the world through a network of correspondent brokers and consultants.

Why Gallagher? As a relationship driven business, we believe that no two businesses are the same. Many have unique qualities that may require fresh thinking and a tailored solution. We have earned a reputation for truly understanding our client's business and finding the best fit solution that covers you for all insurable risks, providing peace of mind for now and the future.

Market Overview Report

Shaping a future for Australia's corporate business community

Connect and join the AJG conversation

@AJG_Australia | in

Arthur J. Gallagher